

810-9-1-.01 Definitions.

(1) A "financial institution" is a national banking association or any person or entity which by employing monied capital as its principal business activity comes into competition with the business of national banks and

(a) for tax years beginning after December 31, 1999, engages in the following businesses within this state: banking; conducting the business of a financial institution as described in Chapter 16, Title 40, Code of Alabama 1975; or conducting a credit card business through the issuance of credit cards to residents or businesses of this state.

(b) "Financial institution" also means those common parent corporations which are registered bank holding companies as defined by the Bank Holding Company Act of 1956, as amended, and which are eligible to elect to file a consolidated Financial Institution Excise Tax Return as specified in §40-16-3.

(c) The term "financial institution" does not include insurance companies, individual citizens or fiduciaries acting in a representative capacity for individual citizens merely because they make loans or investments of funds in bonds, notes or other evidences of indebtedness if such transactions are not made in competition with the business of national banks.

(2) "Net income" is defined as "gross income" less the deductions provided in Chapter 16, and as may be determined under Rule 810-9-1.05, if applicable.

(3) "Gross income" means all wealth flowing to the taxpayer other than return of its capital without credit or exclusion and includes all dividends and interest from whatever source.

(a) Gross income also includes insurance commissions deemed earned within this state by a financial institution which has acted in an agency capacity to secure insurance for its borrowers or credit card holders.

(4) "Deductions" include the ordinary and necessary business expenses incurred in the production of the gross income required to be reported by Chapter 16. If both personal and business expenses are incurred in a single transaction, only the business expenses may be deducted.

(a) Salaries or other compensation for personal service actually rendered are deductible if such payments constitute a reasonable allowance.

1. In the case of proprietorships, no deduction shall be allowed for the value of services rendered by the proprietor.

2. In the case of partnerships, the salary paid to a partner for active management of the business shall be allowed as a deduction so long as the amount can be shown to be reasonable within the judgment of the Department of Revenue. No deduction shall be allowed when the partner's interest is purely financial and active day by day participation in the operation of the business does not exist.

(b) Management fees, to the extent they are reasonable, ordinary and necessary, will be allowed.

(c) Interest expense paid or accrued as an ordinary and necessary business expense is deductible.

1. A domestic corporation or resident individual is entitled to deduct interest paid or accrued to the extent that it is a necessary and ordinary business expense.

2. A branch office of a foreign corporation is entitled to a deduction for interest which shall be that portion of the total interest paid or accrued by the foreign corporation that the gross income in Alabama is to the total gross income of the corporation.

(d) Taxes are deductible only in the year they are paid and only when levied on the taxpayer claiming the deduction.

1. The federal income tax (FIT) paid shall be deductible only to the extent that it is applicable to the financial institution's income earned in the State of Alabama. Any allocation which is necessary shall be determined by applying the ratio of the taxpayer's income in Alabama, before any federal income tax deduction or net operating loss (NOL) deduction, from the financial business to the total company income, before any federal income tax deduction or NOL deduction, as computed under Chapter 16 for the year for which the tax was paid. In the case of corporations, allocation and apportionment of income earned within and without this state shall be determined under Chapter 16 and Rule 810-9-1-.05. The FIT deduction shall be on the same basis as provided by Alabama Income Tax Rule 810-3-35-.01(3)(c)2, except that such tax must be paid during the tax year.

(i) EXAMPLE: Bank C operates in Alabama and other states. Bank C does not file a consolidated federal income tax return or own subsidiaries. Bank C will compute income attributable to this state using Rule 810-9-1-.05. Bank C will determine that portion of the FIT deduction attributable to Alabama by applying the ratio of income attributable to operations within this state before any FIT or NOL deduction, to its total company income before any FIT or NOL deduction computed under Chapter 16. Bank C paid \$100,000.00 of FIT during the year, and had total company taxable income (computed under Chapter 16)

before any FIT or NOL deduction of \$400,000.00. Bank C's Alabama apportionment factor percentage is sixty percent. There are no allocated items of income or expenses to this state. Bank C's Alabama taxable income before any federal income tax and NOL deduction is $(\$400,000.00 \times 60\%)$ \$240,000.00. Bank C's portion of the paid FIT for the year which is deductible on Bank C's Alabama financial institution excise tax return is $(\$240,000.00 \div \$400,000.00 \times \$100,000.00)$ \$60,000.00.

2. In the case of corporate taxpayers which are members of affiliated groups which file consolidated Federal income tax returns, the deductible tax will be allocated and apportioned based upon Alabama income tax Rule 810-3-35-.01(3)(c)2, provided that such tax must be paid during the tax year as required by Chapter 16. Allocation and apportionment of income earned within and without this state shall be determined under Chapter 16 and Rule 810-9-1-.05.

(i) EXAMPLE: Parent P is a bank holding company and files a consolidated federal income tax return with subsidiaries A, B, C, D, and E. Parent P does not operate within this state. Parent P's subsidiaries, A, B, and C, operate within and without this state and subsidiaries, D and E, do not operate within this state. Parent P and subsidiaries A, B, D, and E qualify as financial institutions. Parent P elects to file a consolidated Financial Institution Excise Tax return with this state and pays the \$6,000.00 annual filing fee. Subsidiaries A and B must each determine their own total company taxable incomes under Chapter 16 (before any FIT and NOL deductions). Subsidiaries A and B must then apply their respective apportionment factors to their company's taxable incomes in order to determine their incomes attributable to operations within this state. See Rule 810-9-1-.05. Subsidiaries A and B will each complete a pro forma form ET-1. See Rule 810-9-1-.02(2)(a)2. In this case subsidiary A has total company income of \$100,000.00 and an Alabama apportionment factor of ten percent which resulted in Alabama taxable income of $(\$100,000.00 \times \text{ten percent})$ \$10,000.00. Subsidiary B had total company taxable income of \$200,000.00 and an Alabama apportionment factor of twenty percent which resulted in Alabama taxable income of $(\$200,000.00 \times \text{twenty percent})$ \$40,000.00. Under Alabama Income Tax Rule 810-3-35-.01(3)(c)2. Parent P allocates its FIT on a taxable income to taxable income basis (positive income to positive income). All companies in P's consolidated federal tax return have positive incomes (before any FIT and NOL carryforward deduction). Total income on P's consolidated federal income tax return is \$1,200,000.00 computed under Chapter 16 (before any FIT and NOL deductions). P's consolidated FIT paid during the tax year was \$240,000.00. Subsidiary A's company portion of the consolidated FIT paid is $(\$100,000.00 \div \$1,200,000.00 \times \$240,000.00)$ \$20,000.00. Subsidiary B's company portion of the consolidated FIT paid is $(\$200,000.00 \div \$1,200,000.00 \times \$240,000.00)$ \$40,000.00. Subsidiary A's Alabama excise tax portion of the FIT allocated to subsidiary A from the consolidated federal return is $(\$10,000.00 \div \$100,000.00 \times \$20,000.00)$ \$2,000.00. Subsidiary B's Alabama excise tax portion of the FIT allocated to

subsidiary B from the consolidated federal return is $(\$40,000.00 \div \$200,000.00 \times \$40,000.00) \$8,000.00$. The two pro forma Alabama financial institution excise tax returns will comprise a composite consolidated excise tax return combining the incomes and expenses of the two companies with a total FIT deduction attributable to Alabama operations of $(\$2,000.00 + \$8,000.00) \$10,000.00$.

3. No deduction will be allowed for the excise tax imposed by this chapter or for taxes assessed against local benefits of a kind tending to increase the value of the property against which it is assessed.

4. Any licenses legally levied which qualify and are taken as a credit under Section 40-16-8, shall not be allowed as a deduction in computing net income.

(e) Losses on the disposition of property, not compensated for by insurance or otherwise, are deductible for the taxable year in which the disposition occurs. See the Alabama income tax regulations for determination of basis for gains or losses.

(f) Bad debts may be deducted under either the reserve method or the direct charge off method. The requirements of appropriate regulatory authorities and regulations and rulings of the Internal Revenue Service will be considered. Any adjustment to the deductions or provisions for the reserve for bad debts by the Federal Internal Revenue Service must be made to similar deductions in Financial Institutions Excise Tax returns, the adjustment will be made in the current year by increasing or decreasing the applicable deduction, so that in all cases the reserve balances will be identical for Federal income tax and Alabama excise tax purposes.

(g) Depreciation will be allowed as a deduction and computed as directed in Alabama Income Tax Rule 810-3-15-.05.

(h) Dividends received must be included in gross receipts without exception.

1. A deduction is provided for dividends received from corporations organized and existing under the laws of Alabama.

2. Dividends paid from the capital of the payor corporation in liquidation are deductible by the recipient financial institution. For purposes of this paragraph "capital" means the amounts contributed by shareholders of the payor corporation and does not include its accumulated earnings and profits.

3. Dividends received from its financial institution subsidiaries by the common parent corporation of a group qualified to file a consolidated return under this chapter will be deductible.

(i) Dividends paid by savings and loan associations and credit unions on their withdrawable shares may be deducted by the payor institution.

(j) Net operating losses of financial institutions will be carried back for two years from the year of the loss, and then carried forward for eight years. A loss will be used to offset the income of ten years in addition to the year in which the loss arose, and must be used to offset the income of these ten years in chronological order. The law regarding computing and applying loss carrybacks and carryovers is similar to federal income tax law dealing with this subject. Federal rules and decisions will be considered by the Department in these matters.

1. Net operating losses shall be carried back or carried forward only on the account of the member which incurs the loss.

2. Net operating losses of parent companies shall be allocated among the members of the consolidated Alabama Financial Institution Excise Tax return based on the percentage which the gross assets of each member of the consolidated Alabama Financial Institution Excise Tax return bears to the total gross assets of all members of the consolidated Alabama Financial Institution Excise Tax return.

(5) "State tax year" is defined as the calendar year.

(6) "Taxable year" is defined as a twelve month period which is the fiscal or calendar year of the institution last ended prior to April 1st, of the year in which the tax is to be assessed. Thus, for the "State tax year" 1993, "Taxable years" could end on the last day of any month from April 1, 1992 through March 31, 1993. See §40-16-1(3) for treatment of fractional years or periods.

Author: Anne Simms & Helen Marzette
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